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TAGS: PGOV PREL ECON EFIN GM UK IT KZ
SUBJECT: KAZAKHSTAN: THE GOVERNMENT'S EVOLVING APPROACH TO BTA
TRADE FINANCE DEBT

REF: A. ASTANA 1613
¶B. ASTANA 1509

¶1. (U) Sensitive but unclassified. Not for public Internet.

¶2. (SBU) SUMMARY: Kazakhstani financial officials are negotiating with export credit authorities (ECAs) from at least 14 countries, who have demanded sovereign guarantees for debt repayment on several billion in exposure. For several months, Kazakhstani officials have stood united in their refusal to accept such terms, publicly arguing that such a practice would constitute special treatment for ECA debts compared to other obligations. Although the Kazakhstani government maintains its distance in the resolution of ECA debt, numerous officials have begun expressing a willingness to consider ECA terms. Emboldened by a signed MOU that provides for full repayment on acceptable terms of trade finance debt, ECAs will now push for the government's sovereign guarantee. END SUMMARY.

MOU SIGNED WITH ECA OPTION

¶3. (SBU) Following London negotiations September 10-17, troubled BTA Bank and its creditor steering committee signed a unanimously-accepted memorandum of understanding (MOU) on restructuring that ultimately satisfied a September 18 submission deadline set by the Kazakhstani Financial Supervision Agency (FSA) (ref A). They thus warded off the risk of liquidation. The MOU included an option specifically designed for export credit agencies (ECA) that provides for full repayment of trade finance debt within seven years, with an initial three-year grace period on principal payments. While this ECA option alleviated some fears about trade finance's access to preferential terms, international ECAs remain seriously concerned that full repayment remains in jeopardy without explicit sovereign guarantees.

NATIONAL BANK'S HANDS-OFF APPROACH

¶4. (SBU) Although somewhat receptive, Kazakhstani financial

authorities indicated a strong preference for a quick resolution, and adopted a generally hands-off approach in the days and weeks prior to the signing of the MOU. This tactic left BTA and the members of its steering committee in charge of determining the specific terms of the agreement even for international ECAs who took their case for preferential conditions in restructuring to the top Kazakhstani financial and regulatory agencies. During a September 9 meeting with Chairman of the National Bank of Kazakhstan (NBK) Gregory Marchenko, a delegation of international ECAs comprised of representatives from Italy, Germany, Belgium, Hungary, the United States and Korea pressed their demand for an extension of the strict MOU submission timeline and revision of restructuring terms, which they described as "unprecedented" and "blackmail." Otherwise, they argued long-term economic relations with Kazakhstan would suffer significant consequences.

¶5. (SBU) Marchenko initially recoiled at the suggestion that the government should assume liability for the trade finance obligations of banks that include BTA and Alliance, whose management was fired or are fugitives charged with massive fraud. He responded by rhetorically asking how many ECA executives were fired for "not having seen any of the abundant red flags that were present at the time." Because the NBK believes that most ECA assets ended up being used to finance projects in Russia, Marchenko said the government is distancing itself from restructuring talk -- the banks and creditors must negotiate amongst themselves. He further explained his opinion that the FSA should have begun to limit BTA's banking operations in June because of the risks associated with loss of confidence in the banking sector. Calming a bit, Marchenko said he understood Lazard (i.e. BTA's Financial Advisors) were "playing hardball," but he believed room for negotiation remained.

¶6. (SBU) When ExIm Bank Vice President for Asset Management Frances Nwachuku assessed that "mistakes were made on all sides, including oversight," Marchenko, with unexpected grace, responded that the government does not want to turn its back on the ECAs. However, it is wary, he said, because bad deals backed by sovereign guarantees in the early 1990s cost Kazakhstan nearly $2 billion. Marchenko ended the meeting by calling ECA concerns surmountable, acknowledging the need to defend public funds, and saying he would "speak with the government." However, he closed with a thinly veiled warning that if additional creditor demands made restructuring too expensive, the government would see little use in maintaining the institution.

MORE OF THE SAME FROM THE FSA

¶7. (SBU) The ECA delegation expressed similar concerns and received similar responses during a September 7 meeting with the Director of the FSA Banking Supervision Department Mukhtar Bubeyev. Bubeyev repeated the official government position that negotiations remain solely between the banks and their creditors, and that the FSA exercises no influence over the process. Denying Germany's Euler Hermes' accusations that FSA certainly plays a central role in the process, Bubeyev explained that FSA's primary role will be to review the restructuring proposals. If FSA does not believe that the plans leave the banks with sufficient capital and liquidity, it will reject them.

¶8. (SBU) The banks and the creditors alone must negotiate the potential separation of ECA trade finance and commercial debt, he said. According to Bubeyev, some ECAs conducted "proper banking business," as opposed to "true trade finance." However, the government planned to leave resolution of this issue to the banks and creditors. The FSA, he argued, is charged with the maintenance of financial stability in Kazakhstan, and public confidence is tantamount to stability. Diminishing public confidence precluded the possibility of any extension. Finally, without mincing words, Bubeyev said, "The bank (BTA) has been operating with negative capital since June; we are expecting a bank run. The deadline is firm."

BTA OPEN TO ECA OPTION

¶9. (SBU) BTA Chairman and Samruk-Kazyna Co-Chairman Arman Dunayev explained in a September 7 meeting with ECA creditors that he personally had hoped to keep ECA debts separate from commercial finance in the restructuring process. However, he understood that other creditors on the steering committee wanted immediate cash returns and were heavily influencing the process. According to Dunayev, Samruk-Kazyna Chairman Kairat Kelimbetov had acknowledged the need for ECAs' preferential treatment. Dunayev urged the group to raise the issue with the steering committee, but refused an Euler Hermes request for a strongly-worded endorsement of their position, saying that he had no legal right to interfere in negotiations.

¶10. (SBU) Reflecting the final outcome, Dunayev highlighted the firmness of the September 18 MOU deadline, but indicated they could sign a final agreement by November 15. "Right now, it is very important to sign an MOU; otherwise we risk actions being taken by the FSA," he said. At the same time, he emphasized that the agreement could be preliminary. Dunayev also admitted that he learned of some possibly fraudulent ECA-financed assets in Russia.

¶11. (SBU) In conclusion, Dunayev again expressed his support for the ECA position, but acknowledged competing interests. "I'm very concerned. It seems like there are a lot of lions, ECA and Commercial banks, and jackals, small investors, who want a piece. I will recommend that you are treated differently, but you are lions. Crisis comes and goes, but business stays. I hope the situation around BTA and Alliance will be sorted out. I hope we buy back all

debts, ECAs first, according to an appropriate schedule. I hope we find a proper solution."

MINFIN OPENS DOOR TO SOVEREIGN GUARANTEE

¶12. (SBU) The combined international ECA delegation concluded its trip with September 8 talks in Astana with Minister of Finance Bolat Zhamishev. Reiterating his September 4 discussion with Ambassador Hoagland (ref B), Zhamishev defended government actions and noted the initial decision to bail out the banks in February, rather than simply liquidate, as the strongest proof of its support. Zhamishev emphasized the lack of legal precedent for this decision and for the potential use of public funds to cover obligations never taken on by the government. He restated the government position that half of the ECA financing was used for projects in Russia. Regardless, he argued, a government bail-out of these debts is a politically sensitive issue.

¶13. (SBU) At the same time, Zhamishev referenced a recent conversation with Dunayev and announced his support for ECA preferential treatment if the BTA steering committee reaches such a consensus. Consistently defending his actions to date, and maintaining a delicate distance from other regulatory agencies including the FSA, Zhamishev finally conceded that the Kazakhstani government might assume sovereign guarantees, but only with the condition that such a move would not be activated in the near future. "Our budget is limited. Please keep this in mind -- but, based on what I know, I think we will find a compromise."

WHAT NOW?

¶14. (SBU) With a signed and submitted MOU, the difficult task of due diligence resumes. BTA must evaluate its toxic assets, which will be contentious on all sides. (NOTE: BTA is paying KPMG for this service. In turn, the BTA steering committee is financing oversight of KPMG's work by Deloitte. END NOTE.) The end goal remains the signing of a legally-binding agreement in the middle of November.

¶15. (SBU) COMMENT: The signing of the BTA MOU accomplished one of the immediate goals of the Kazakhstani government. The local media are hailing it as a success, which is likely part of a concerted public relations initiative to restore confidence in the beleaguered Kazakhstani banking sector. It should also satisfy the immediate demands of the international ECAs. However, as KPMG and their Deloitte minders work to unravel the tangled web of toxic assets in

an attempt to establish true value, contentious results will likely emerge for creditors, BTA management, and regulatory agencies. Should the U.S. government consider joining international colleagues in pressing for preferential treatment of trade finance debts, we should exercise a degree of caution, making certain that we do not ask Kazakhstan to accept liabilities we would be unwilling to take on ourselves. END COMMENT.

HOAGLAND